BBVA Research

China Banking Monitor

March 15, 2023

Creating Opportunities

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Index

Main takeaways

Aggregate credit growth remained subdued in 2022 amid a slowing economy, while new bank lending rebounded to a record high in January 2023 thanks to the exit of Zero COVID policy.

Bank assets growth saw a faster expansion in response to regulators' renewed call for more credit support to corporate borrowers.

Despite of the lower funding costs, banks' profitability is weighed by narrowing interest rate margins amid a challenging operating environment.

The NPL ratio declined as banks' sustained disposal of bad loans. However, non-performing loan formation remains a major source of risk to asset quality.

Capital adequacy ratio remained stable, but needs more capital to support its forthcoming credit spree. Small lenders are still subject to capital shortfalls.

Although bank's exposure to the housing sector is declining, the risks associated with property market could exacerbate the debt overhang problem.

Banks interconnectedness with the shadow banking system continue to diminish.

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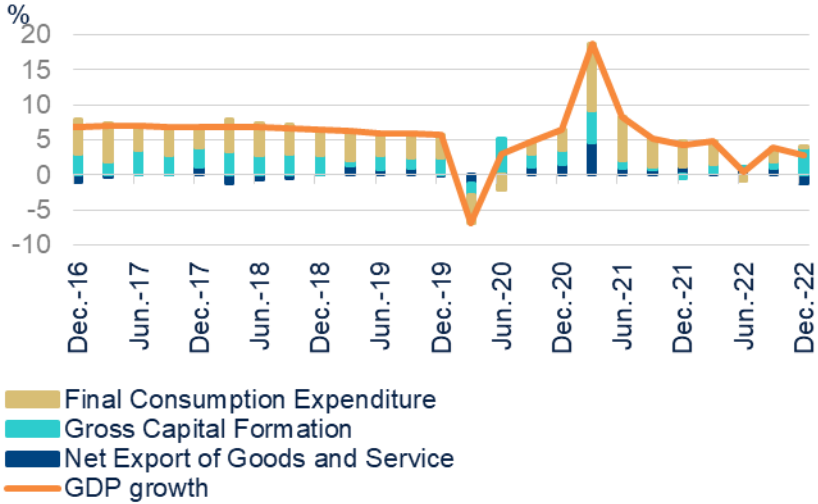
01

Macroeconomic environment

Weaker-than-expected credit growth in 2022 amid a slowing economy

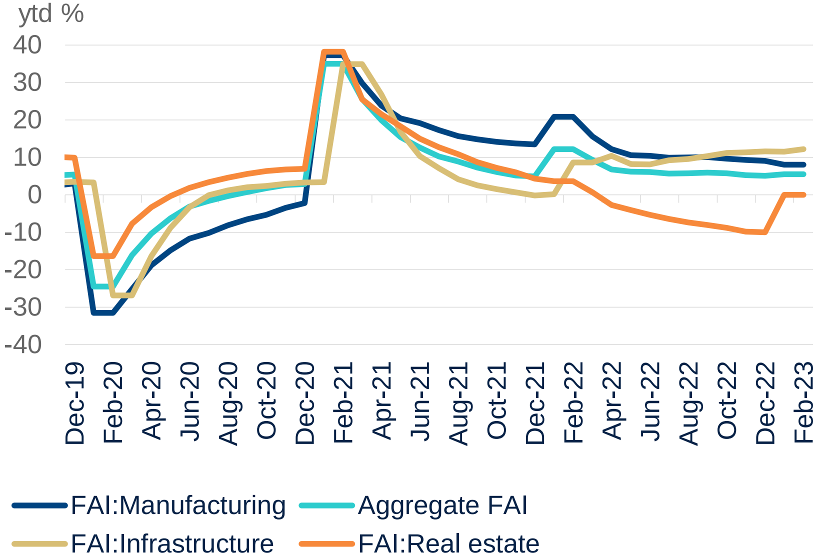
A bumpy V-shape recovery amid disordered “Zero covid” relaxation

GROWTH SLOWED TO 2.9% IN Q4 FROM 3.9% IN Q3, CONCLUDING 2022 GDP AT 3.0%



Source: CEIC & BBVA Research.

WEAK REAL ESTATE FAI STILL WEIGHED ON FAI, WHILE INFRASTRUCTURE FAI PICKED UP

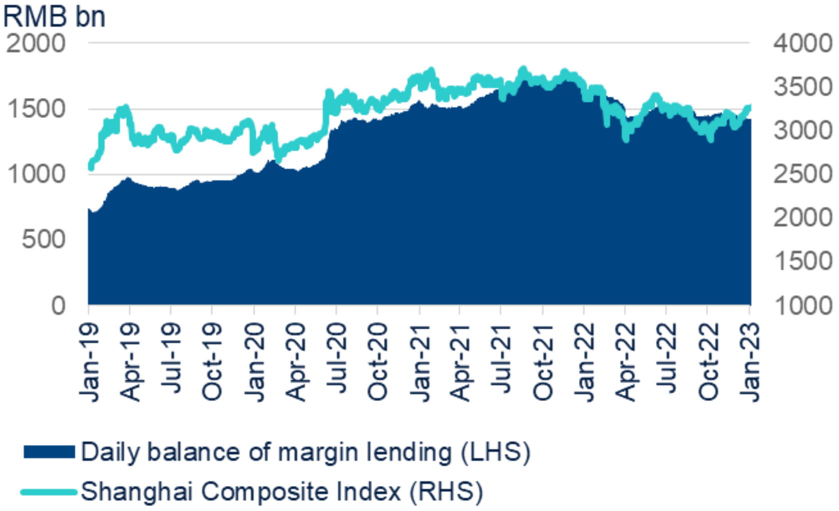


Source: CEIC, Haver & BBVA Research

The economic growth slowed to 2.9% y/y in Q4 from 3.9% y/y in Q3, concluding 2022 GDP at 3.0%, amid a number of headwinds including weak consumer demand, intermittent COVID-related mobility restrictions and beleaguered property market.

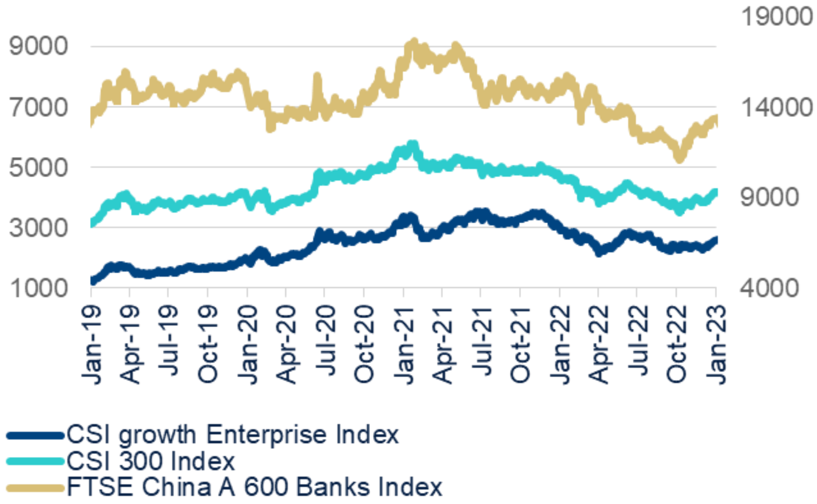
China's stock market remained sluggish in 2022 but saw a pick up after the economy reopened

SHANGHAI COMPOSITE INDEX GOT A BOOST FROM THE EXIT OF ZERO COVID POLICY



Source: Wind & BBVA Research

…AS WELL AS CSI 300 INDEX AND FTSE CHINA A600 BANKS INDEX

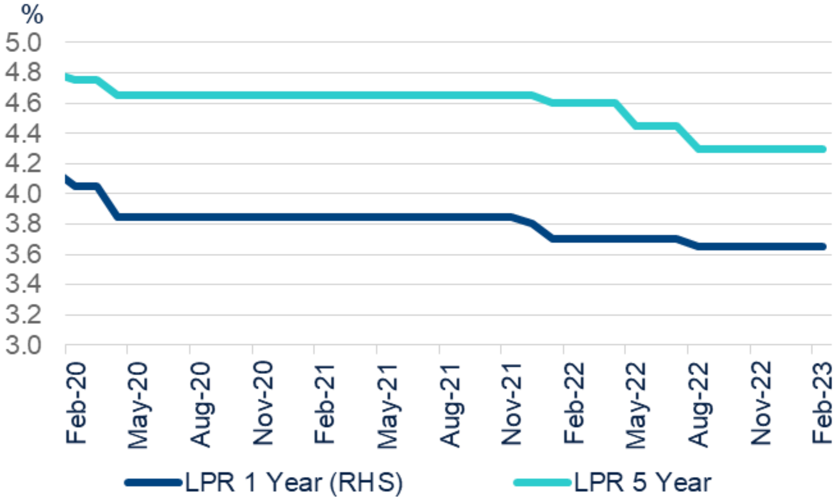


Source: Wind & BBVA Research

China's abrupt exit of Zero Covid policy gave rise to a stock market rally. In the aftermath of China's reopening, both the Shanghai Composite Index and CSI 300 index revised their previously declining trend.

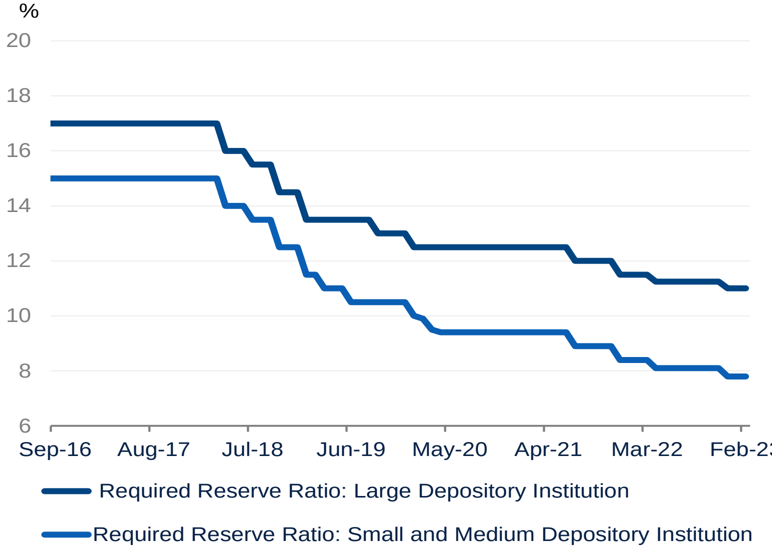
Easing monetary policy to accommodate growth to prevent growth hard-landing

HOEVER, THE PBOC MAINTAINED LPR AFER AUGUST'S CUT AMID AGGRESSIE FED HIKE



Source: Haver & BBVA Research

THE CENTRAL BANK HAS CUT RRR 2 TIMES IN APRIL AND DECEMBER RESPECTIVELY IN 2022

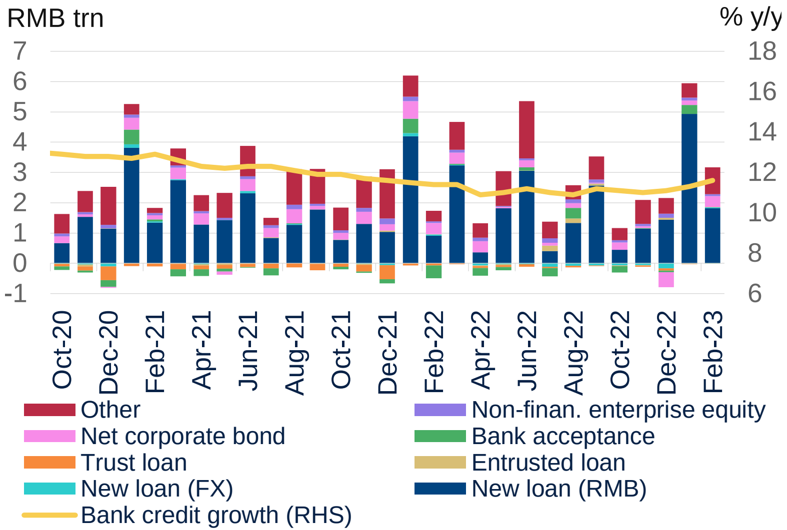


Source: CEIC & BBVA Research

The central bank cut the 5-year loan prime rate, a reference interest rate for mortgages, twice in 2022. In addition, the central bank cut 1-year loan prime rate in August and cut reserve requirement ratio for banks twice during the past year.

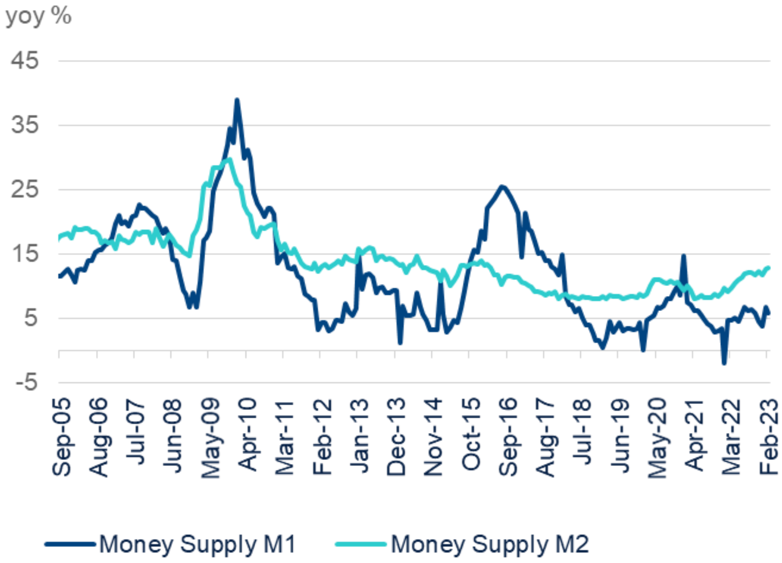
Credit growth remain subdued in 2022 amid a slowing economy but rebounded quickly in 2023

TOTAL SOCIAL FINANCING REBOUNDED IN 2013 AMID THE ECONOMY RECOVERY



Source: CEIC & BBVA Research

…SO DID M2 GROWTH RATE

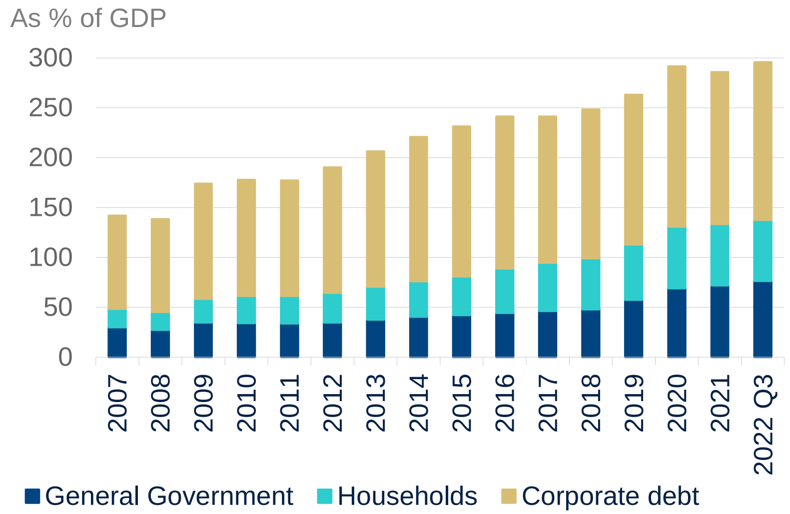


Source: Wind & BBVA Research

Growth of outstanding total social financing (TSF), a broad measure of credit and liquidity in the economy, slowed to single digit growth at 9.6% in December 2022. However, new bank lending set a record high to RMB 4.9 trillion and 1.8 trillion in Jan and Feb 2023 respectively, in response to the central bank's call to support the COVID-ravaged economy.

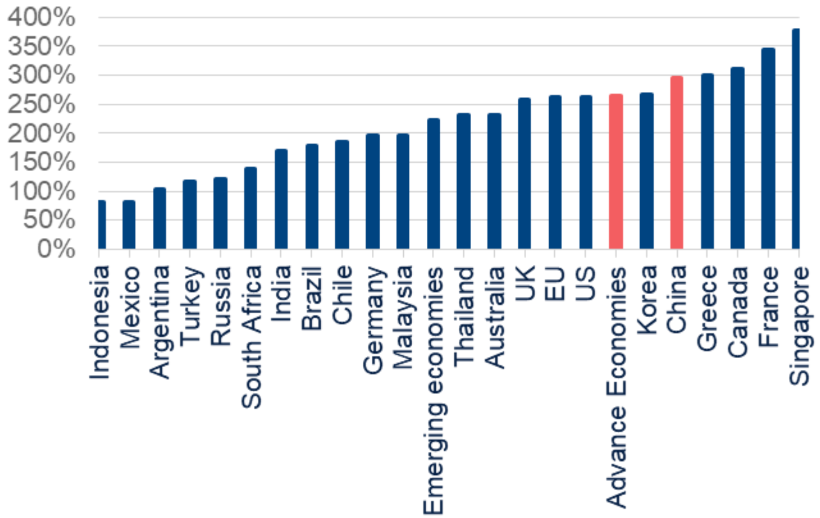
China’s debt overhang concentrates on local government debt and corporate debt

CHINA’S MACRO LEVERAGE RATIO REACHED 295.3% TILL Q2 2022



Source: CEIC & BBVA Research

CHINA’S MACRO LEVERAGE RATIO IS HIGHER THAN EMERGING MARKETS AVERAGE



China’s macro leverage ratio, defined as total debt as % of GDP, rose to the record high of 295.9% at Q3 2022, 9.2% points higher than the same period last year. However, the debt overhang issue mainly focus on corporate debt and local government debt, while homebuyers are rushing to pay down mortgages as banks lowered mortgage rates.

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02

Performance of banking Sector

Asset quality is subject to headwinds

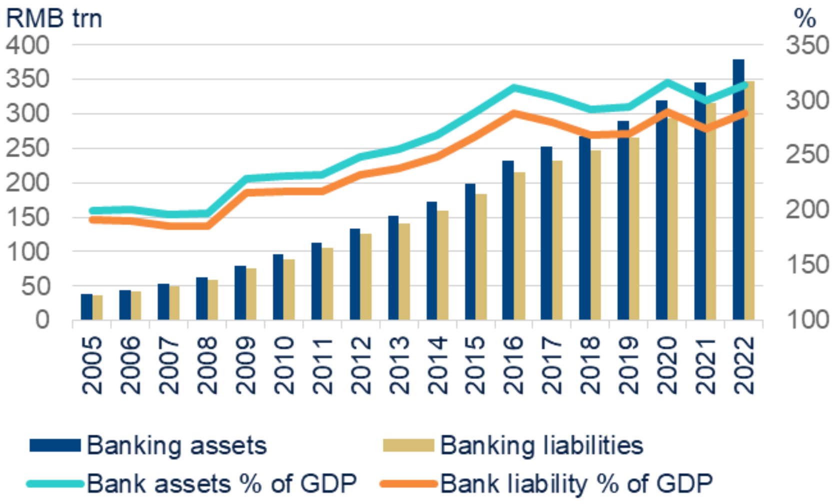
A snapshot of financial fundamentals of Chinese banks

	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4
Asset quality and credit risk										
Loans/total assets	53.7%	54.0%	54.7%	55.2%	55.8%	55.9%	56.2%	56.1%	56.4%	56.4%
NPL ratio	1.96%	1.84%	1.80%	1.76%	1.75%	1.73%	1.69%	1.67%	1.66%	1.63%
(NPL+special-mention loan) ratio	4.41%	4.41%	4.22%	4.12%	4.11%	4.06%	4.00%	3.98%	3.93%	3.86%
Provisions/NPLs	179.9%	184.5%	187.1%	193.2%	197.0%	197.0%	200.7%	203.8%	205.5%	205.9%
Profitability & efficiency										
NIM	2.09%	2.10%	2.07%	2.06%	2.07%	2.08%	1.97%	1.94%	1.94%	1.91%
Cost to income ratio	28.1%	31.2%	27.1%	28.1%	29.0%	32.1%	27.7%	28.9%	30.0%	34.0%
ROE	10.1%	9.5%	11.3%	10.4%	10.1%	9.6%	10.9%	10.1%	9.3%	9.3%
ROA	0.80%	0.77%	0.91%	0.83%	0.82%	0.79%	0.89%	0.81%	0.75%	0.76%
Solvency										
Tier 1 ratio	11.7%	12.0%	11.9%	11.9%	12.1%	12.4%	12.3%	12.1%	12.2%	12.3%
Core Tier 1	10.4%	10.7%	10.6%	10.5%	10.7%	10.8%	10.7%	10.5%	10.6%	10.7%
Leverage ratio	6.7%	6.9%	6.9%	6.9%	7.0%	7.1%	7.0%	6.8%	6.8%	6.9%
NPLs/ Capital	11.9%	11.0%	11.1%	10.9%	7.0%	10.4%	10.3%	10.4%	10.3%	10.1%
Liquidity and funding										
Deposits/Total assets	67.0%	68.3%	68.9%	69.4%	69.4%	80.5%	80.5%	80.9%	80.9%	80.8%
Non-deposits funding (Central bank, bonds, NCDs, ...) / Total assets	37.2%	37.7%	37.4%	37.6%	38.1%					
Loan to deposit ratio	75.5%	76.8%	77.2%	78.1%	79.1%	79.7%	78.7%	78.4%	78.7%	78.8%
Liquidity coverage ratio	138.7%	146.7%	141.8%	141.2%	142.2%	145.3%	143.2%	146.3%	142.7%	147.4%

Source: CEIC & BBVA Research.

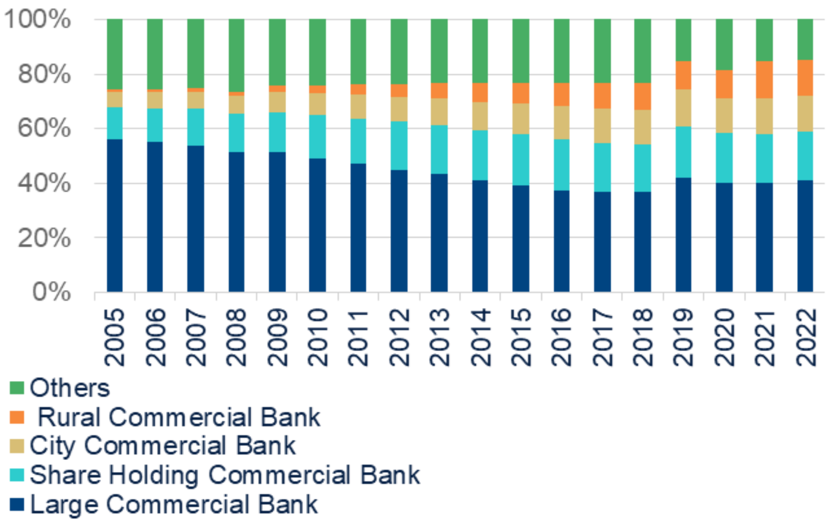
Bank assets growth saw a faster expansion in the first three quarters of 2022

BANKING ASSETS ACCELERATED ITS GROWTH RATE



Source: CBIRC & BBVA Research

LARGE AND SHAREHOLDING COMMERCIAL BANKS STILL DOMINATE IN BANKS' ASSETS

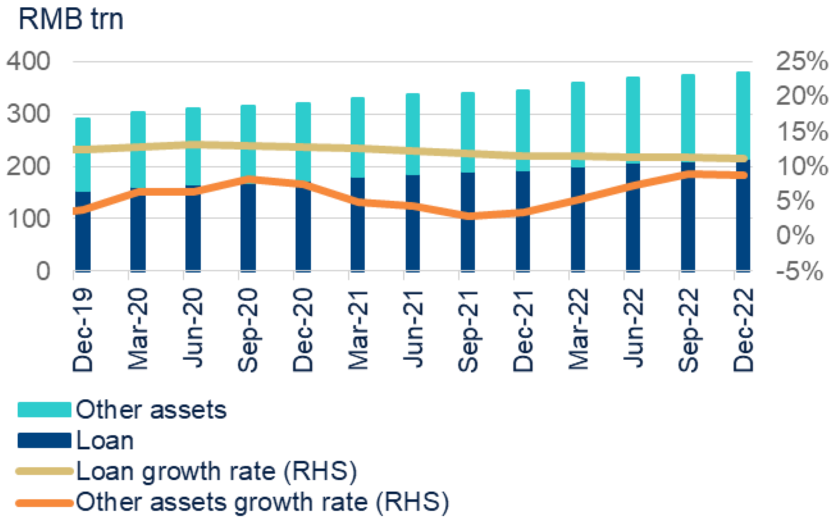


Source: CBRIC & BBVA Research

China's banking sector assets accelerated to 10.0% in 2022 (RMB 379.4 trillion) compared to just 7.8% in the previous year (RMB 344.8 trillion), in response to regulators' renewed call for more credit support to corporate borrowers. Moreover, our breakdown data showed that large and share-holding banks jointly accounted for 69.4% of the total commercial banks' assets.

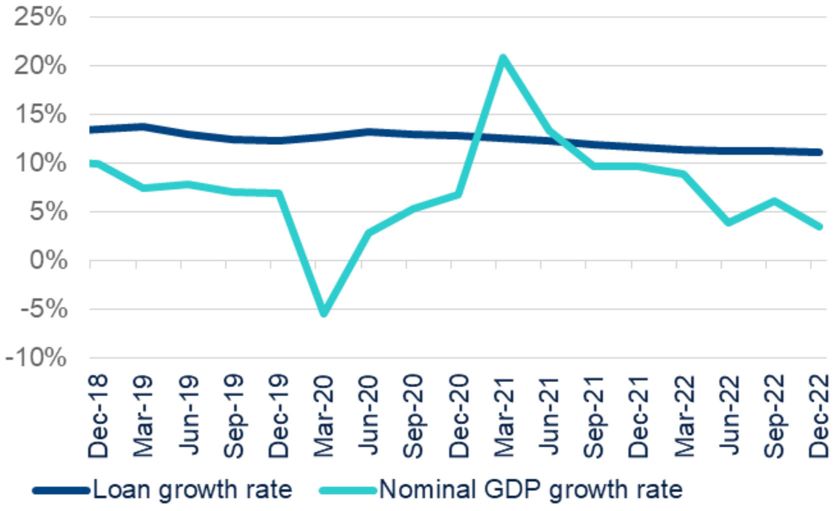
Loan growth moderate slightly while non-loan assets growth picked up

LOAN ASSETS GROWTH CONTRIBUTED TO THE BANKING ASSET EXPANSION



Source: CEIC & BBVA Research

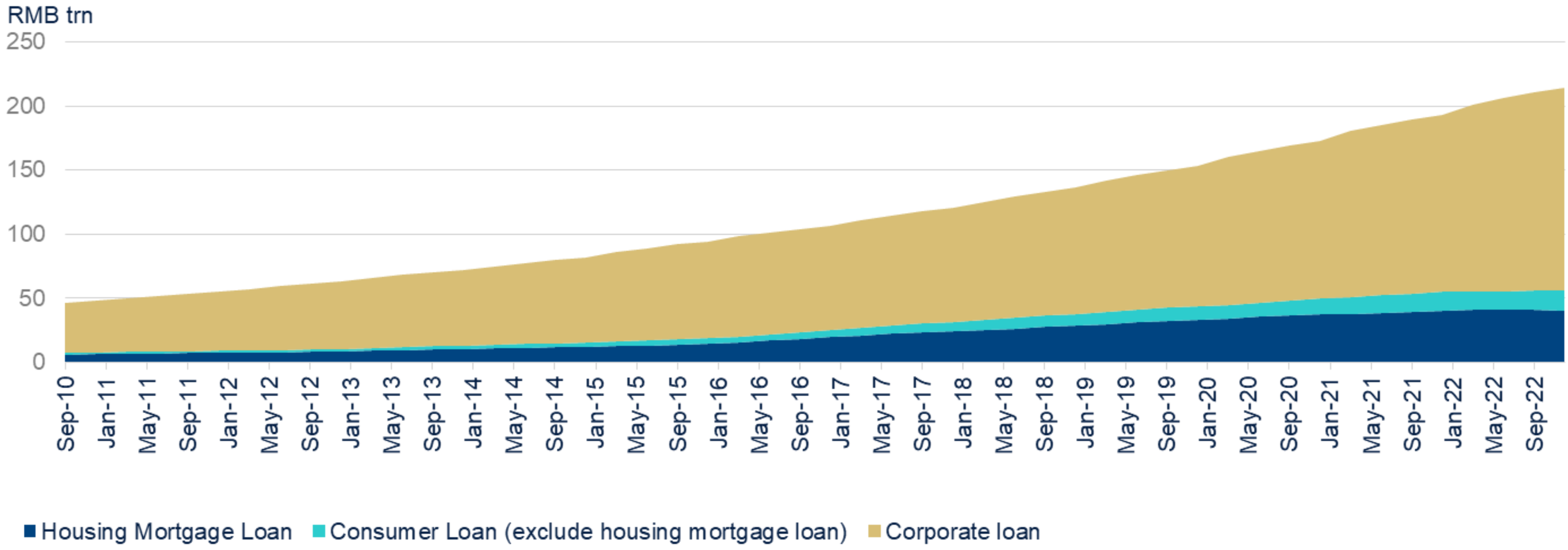
…AND LOAN GROWTH RATE STILL EXCEED NOMINAL GDP GROWTH RATE



Source: CEIC & BBVA Research

Loan growth came out at 11.1% in 2022 compared with 11.5% in 2021. In contrast, the growth of non-loan assets jumped to 8.8% in 2022 from 2.8% in 2021, driven by increasing bond purchase and interbank activities.

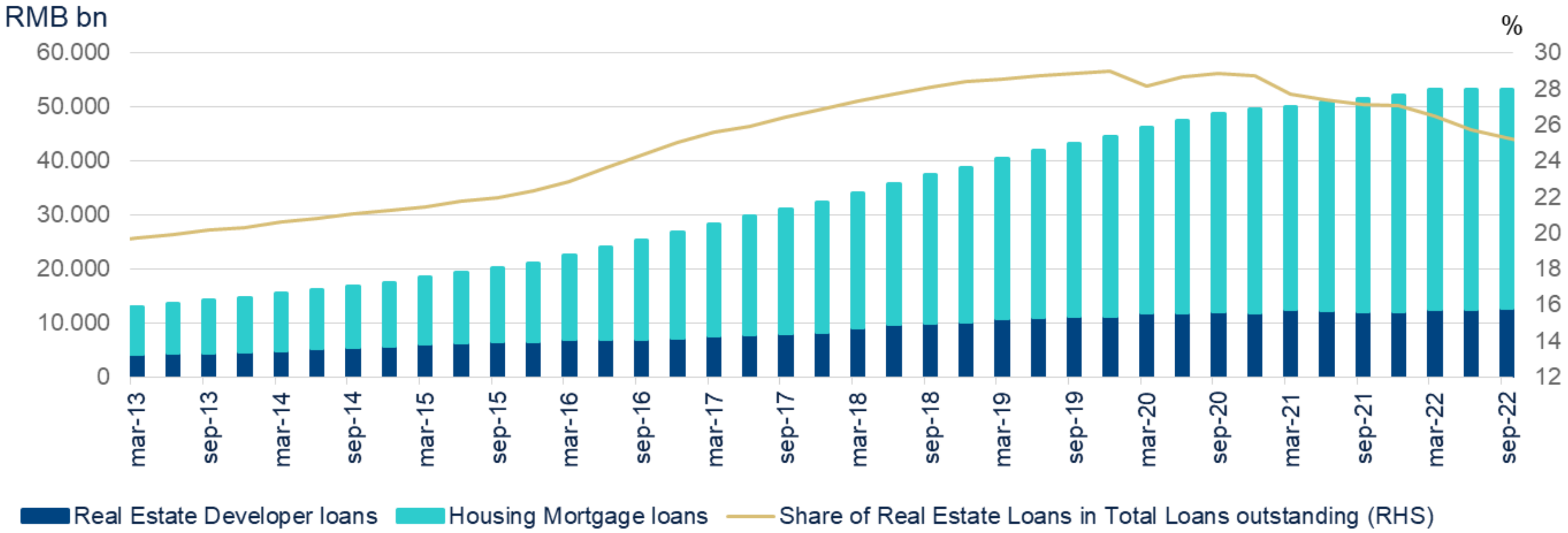
Housing mortgages and retail loans weighed on loan growth rate



Source: CEIC & BBVA Research

Consumer loan growth has tumbled to 5.7% y/y in 2022, as consumption activities and housing mortgage loan demand were severely affected by pandemic-related restrictions. In contrast, corporate loans jumped to 14.6% in 2022, thanks to government's call for boosting the real economy through more lending to infrastructure, manufacturing ,"green" finance and SMEs.

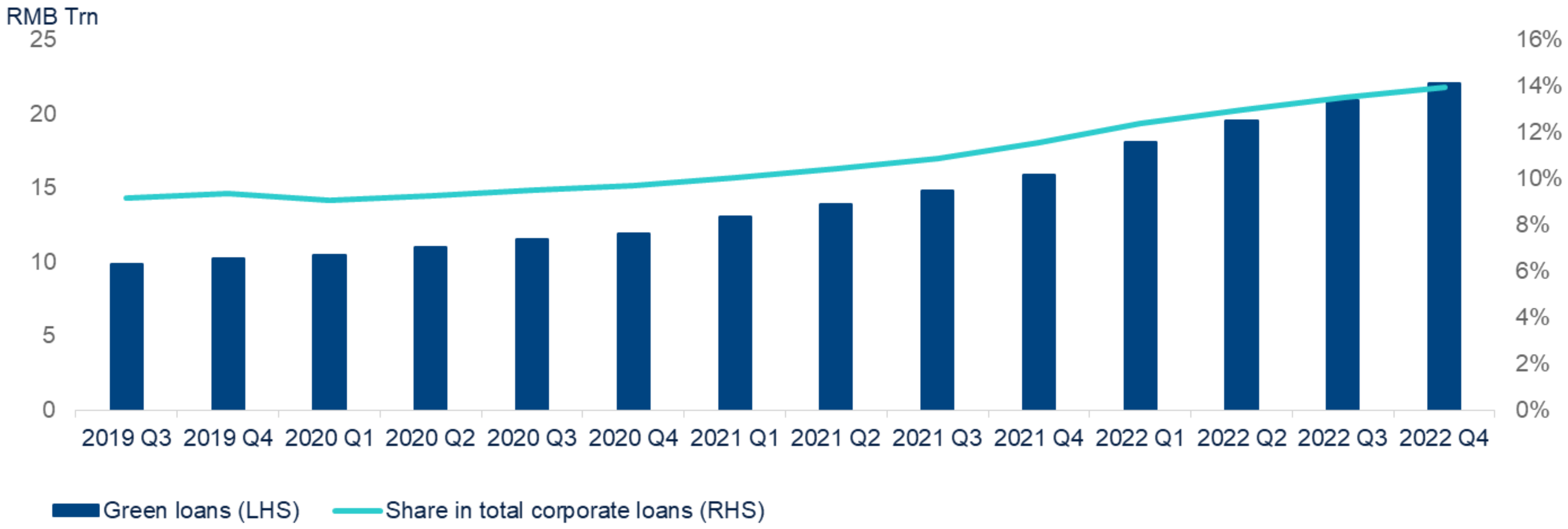
Bank's exposure to housing sector was trending down



Source: CEIC & BBVA Research

China's banking sector's aggregate loans to real estate sectors (mortgage loans plus real estate developer loans) have slowed down to 24.8% from its peak level of 29%, as banks remain cautious towards new property exposures.

By contrast, green loan growth accelerated

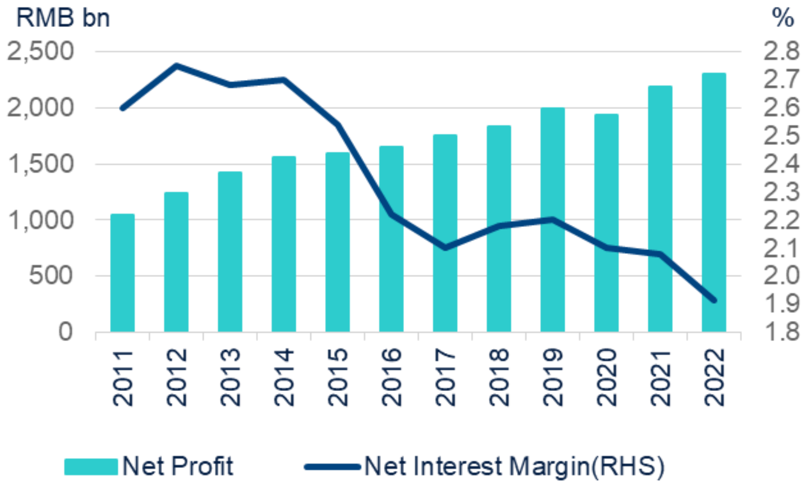


Source: CEIC & BBVA Research

In response to the national priority of carbon neutrality initiative, banks are accelerating lending and investment in green projects including renewable energies, electric vehicles and new infrastructure etc. Consequentially, green loan growth accelerated to 38.6% at end 2022 and this trend is likely to maintain in 2023.

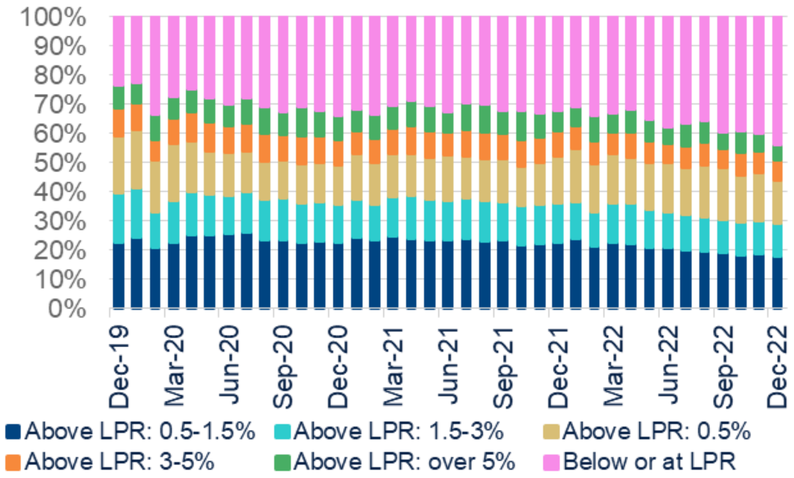
Banks' profitability was under pressure due to narrowed interest rate margin

NET INTEREST MARGIN (NIM) SEE FURTHER DECLINES



Source: CBRIC & BBVA Research

THE PROPORTION OF LENDING RATE BELOW OR AT LPR CONTINUES TO RISE



Source: CBRIC & BBVA Research

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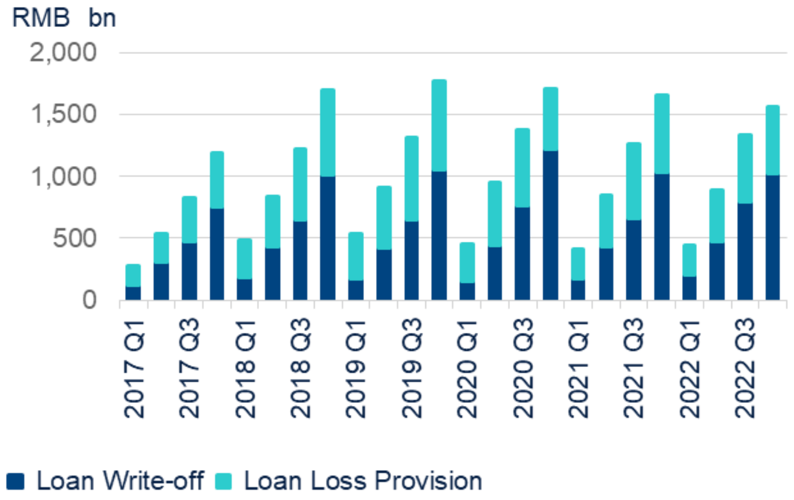
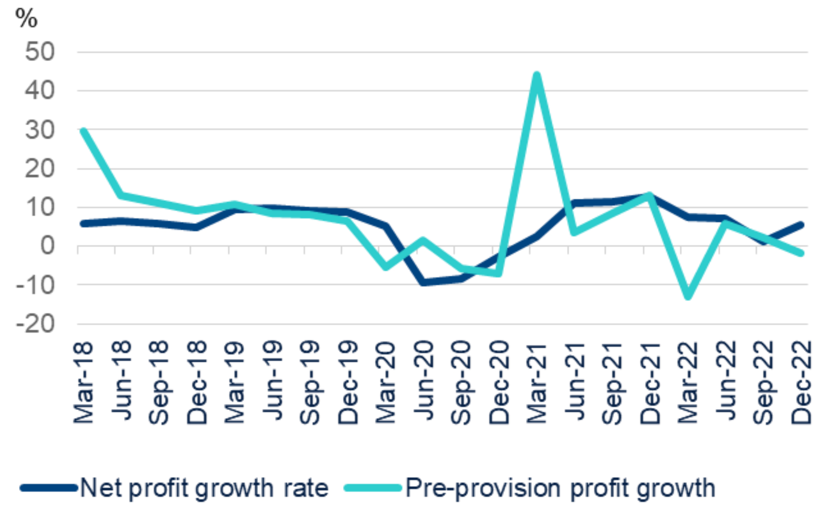
Bank's provisions for bad loans have moderately slightly

BAD LOAN RESOLUTION REMAIN SUSTAINED WHILE LOAN LOSS PROVISION DECLINED



Source: CBRIC & BBVA Research

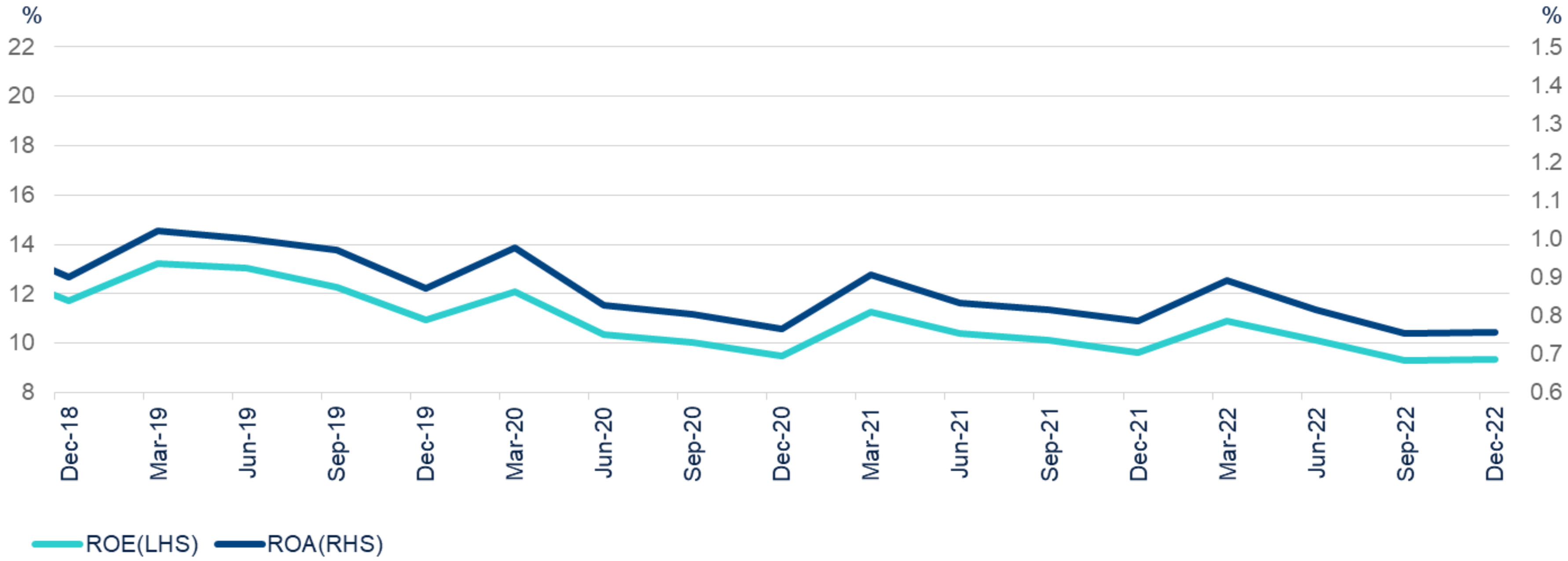
BANKS' PRE-PROVISION PROFIT GROWTH RATE WERE BELOW THAN NET PROFIT GROWTH RATE



Source: CBRIC & BBVA Research

The executive meeting of the State Council held on April 2022 encouraged large banks with relatively high provision levels to reduce their provision coverage ratios in an orderly manner to channel the fund to support the real economy. As a result, banks' provisions for bad loans have moderated to RMB 534.3 compared with RMB 622.5 the same period last year.

ROA and ROE registered the lowest record in more than 10 years

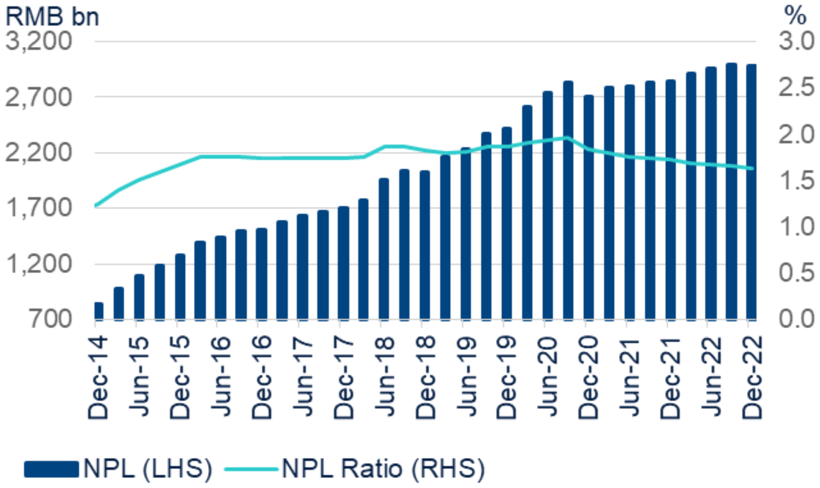


Source: CBRIC & BBVA Research

Both ROE and ROA dropped to 9.3% and 0.76% respectively in 2022, registering their lowest levels in more than a decade. In particular, the ROE and ROA for large and share-holding commercial banks stayed broadly flat as they benefited from lower market interest rates. However, city and rural banks had to pay higher funding costs for ever-intensifying deposit competition.

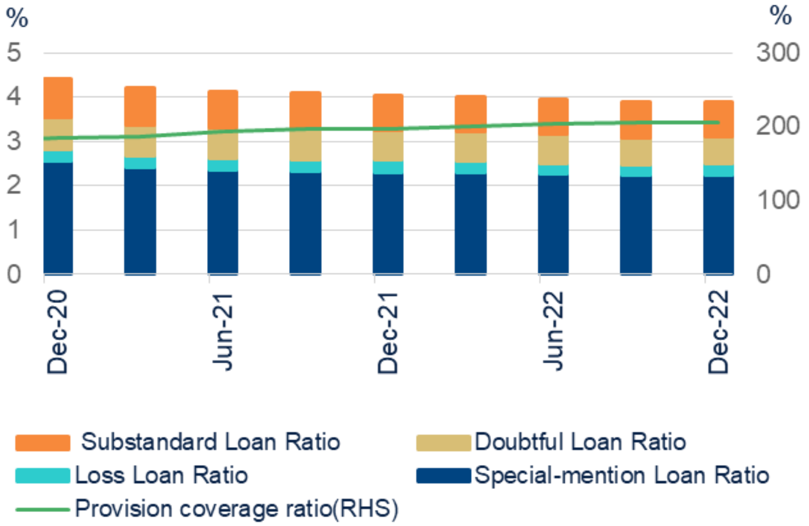
Although both NPL ratio and special-mention loan ratios declined due to a sustained NPL disposal, asset risks are rising

NPL RATIO MODERATED WHILE NPLS LEVEL REMAINED HIGH



Source: CEIC & BBVA Research

…SPECIAL- MENTION LOAN RATIO ALSO DECLINED AS CONTINUOUS DISPOSAL OF BAD LOANS

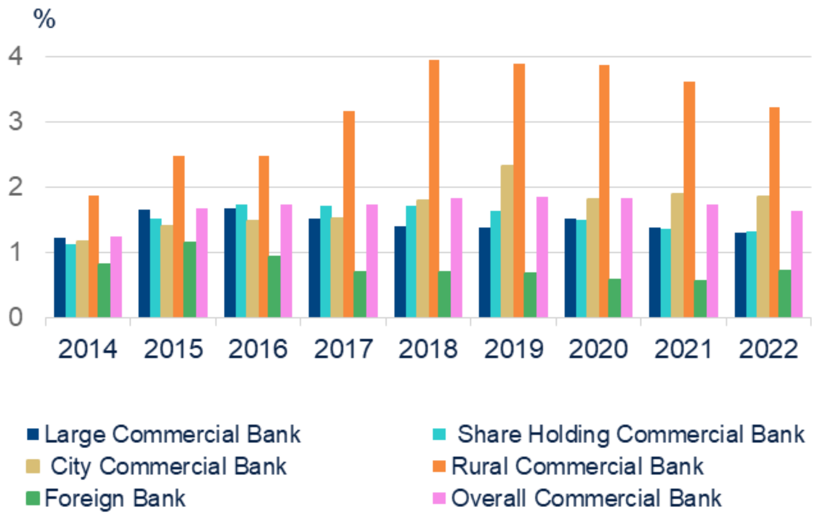


Source: CEIC & BBVA Research

Both the NPL ratio and special-mention loan ratios edged down slightly to 1.63% and 2.25% respectively in the Q4 2022 from 1.73% and 2.31% respectively a year ago, supported by a sustained effort in NPL disposal. However, new nonperforming loan formation remains a major source of risk to asset quality.

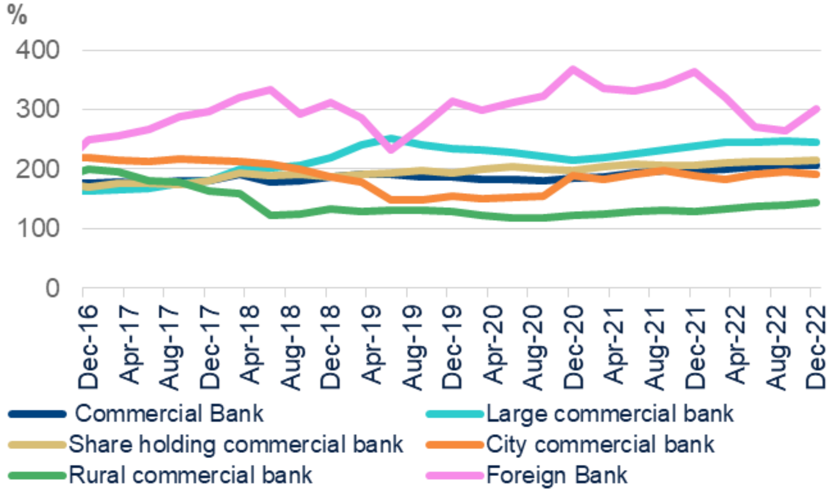
Loan quality diverged between big banks and regional banks

RURAL COMMERCIAL BANKS ARE VULNERABLE TO FURTHER ASSET DETERIORATION (NPL RATIO %)



Source: CEIC & BBVA Research

THE PROVISION COVERAGE RATIO FOR RURAL COMMERCIAL BANKS IS UNDER THE REGULATORY REQUIREMENT

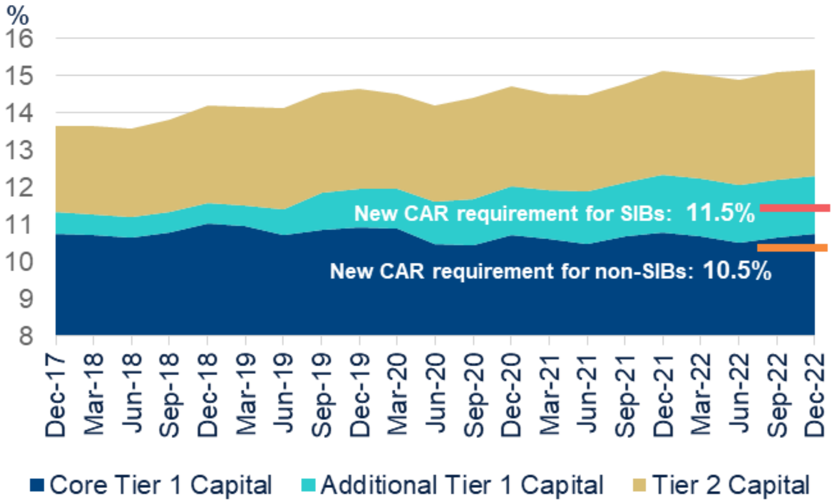


Source: CEIC & BBVA Research

Rural and city commercial banks are still vulnerable to further asset quality deterioration given their less diversified asset portfolios and higher exposure to real estate. In particular, rural commercial banks collectively have a provision coverage ratio of about 143.2%, which is lower than the upper bound of supervisory requirement of 150%.

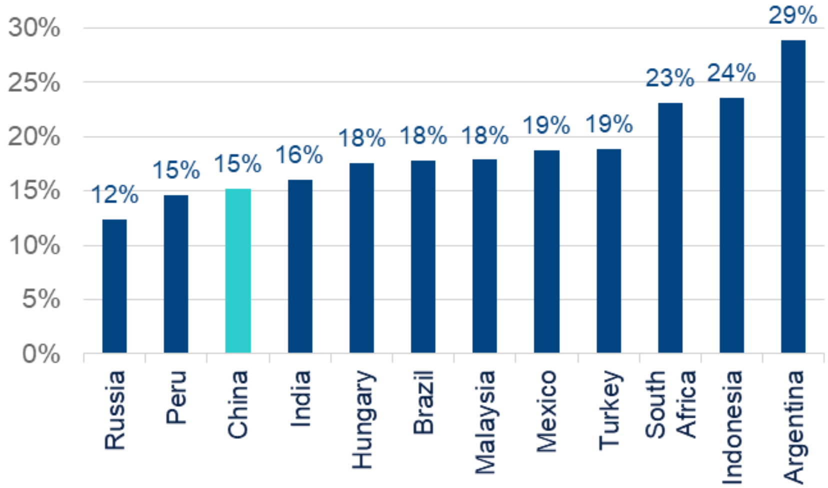
Banks' capitalization remained stable, but needs more capital to support its forthcoming credit spree

CORE TIER 1 CAPITAL ADEQUACY RATIO HAS DECLINED SIGNIFICANTLY



Source: CEIC & BBVA Research

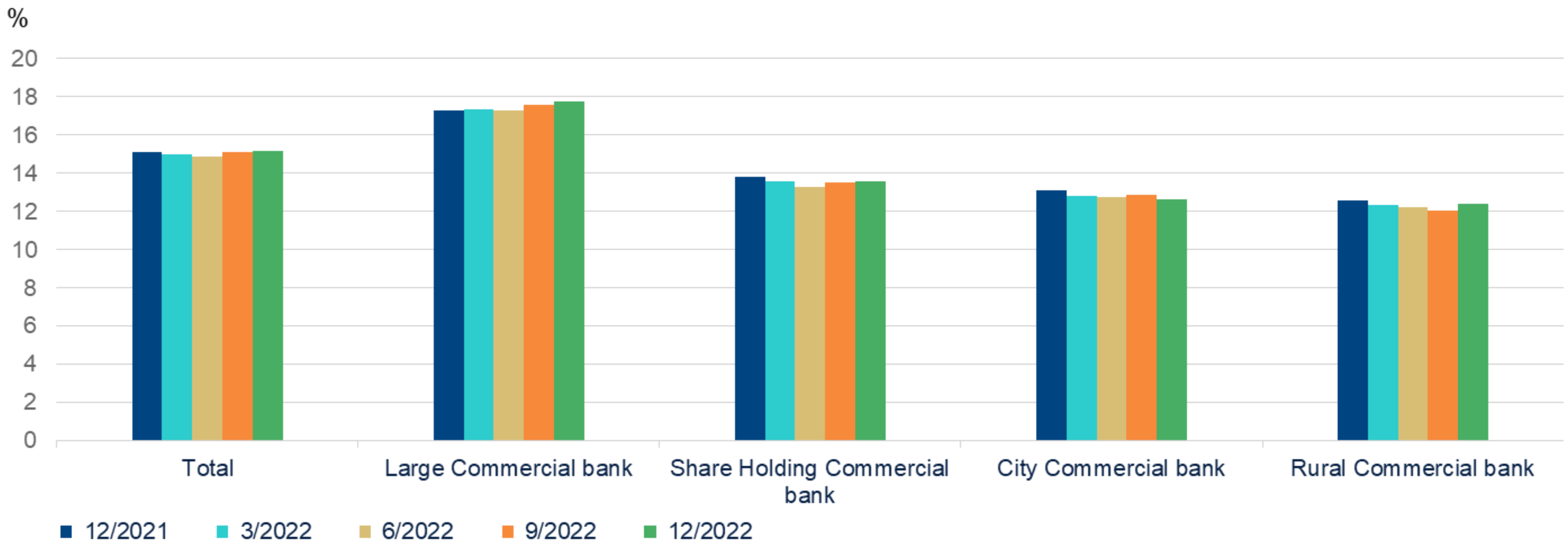
AND CHINESE BANKS' CAR STILL LAG BEHIND THEIR MAJOR EMS PEERS



Source: CEIC & BBVA Research

Bank capitalization remained stable, while the core tier 1 capital ratio edged down to 10.7% at end-2022, 1 basis points lower than a year ago. Meanwhile, additional tier 2 capital ratio rose by 9 basis points over the same period, driven by the issuance of perpetual bonds.

A diverged capital buffer distribution among big and smaller banks



Source: CBRIC & BBVA Research

City and rural commercial banks have lower capital adequacy ratios due to their larger exposure to the property sector as well as their higher sensitivities of funding costs.

China to build differentiated capital regulatory system for banks

BANKS ARE CLASSIFIED INTO THREE BUCKETS BASED ON BUSINESS SCALE AND RISK LEVEL

Classification	Assets size (including on and off balance sheet)	Cross-boarder exposures	Capital regulatory measures	Intentions
Tier 1	Over or equal to RMB 500 billon	Over or equal to RMB 30 billon	In line with international standard to disclose a complete set of reports	Enhance the risk sensitivity of large banks capital management and improve the comparability of their capital ratios and public disclosures in a global context.
Tier 2	Over or equal to RMB 10 billon	Below RMB 30 billion	Subject to relatively simplified capital regulatory measures	Reduce compliance costs for middle and small banks to serve the real economy.
Tier 3	Less than RMB 10 billon	Not involved in any cross-boarder business	Simplify capital requirements although not lower standard	Facilitate them in better serving the county economy as well as small and micro businesses.

Source: China Banking and Insurance Regulatory Commission & BBVA Research

The CBIRC and PBoC jointly issued the amended draft rules for consultation on the revised capital measures on 26th Feb 2023. The new regulation will put differentiated supervision on bank capital to reduce compliance costs for small and medium-sized banks, and improve banks’ ability to serve the economy. The new rule is expected to be implemented in Jan 2024.

Risks exposure rules are also refined

SUMMARISED RISK WEIGHTS REVISIONS UNDER STANDARDISED APPROACH

Exposure type	Current rules in China		New rules (for consultation)	Final Basel III rules
Corporate exposure	Investment grade corporates	100%	75%	65%
	Small & medium-sized enterprises	100%	85%	85%
	Property development loans failing to meet specific prudential standards	100%	150%	150%
Retail exposure	Residential mortgage (if not dependent on cash flows generated by the property)	50%	40% for LTV below 60%; 45% for LTV between 60% to 80%	20% for LTV below 50%; 25% for LTV between 50%-60%; 30% for LTV between 60%-80%
	Revolving retail loans to transactors*	75%	45%	45%
Exposure to banks	Senior debts with maturities over three months	25%	30% for Grade A+ banks** 40% for Grade A banks***	30% for Grade A+ banks 40% for Grade A banks
Exposure to non-central government-related public sector entities	Subordinated debt & capital instruments	100%	150%	150%
	Local government general bond	20%	10%	0%-50% for public sector entities within sovereigns rated at A- category or higher***, subject to discretion at local authorities

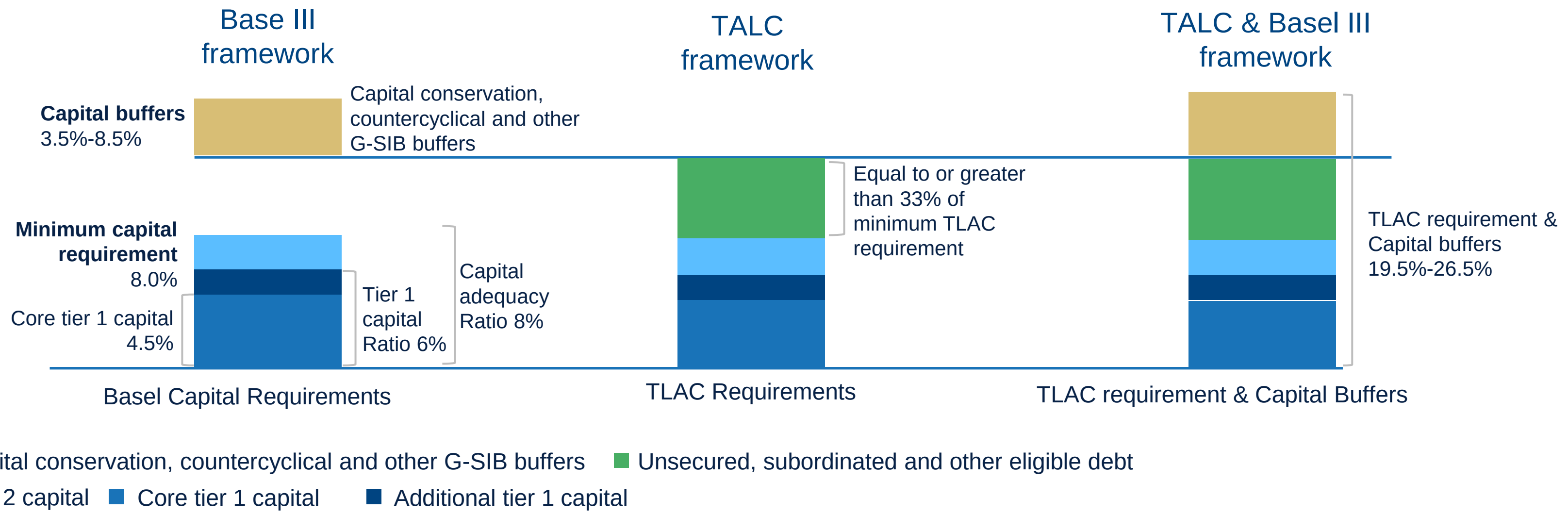
Note: *Transactors are obligors in relation to facilities such as credit card where the balance has been repaid in full at each scheduled repayment date for the latest 12 months in the past 3 years. **Grade A banks are those with adequate capacity to meet their financial commitments in a timely manner irrespective of the economic cycles and business conditions, and must meet or exceed the published minimum regulatory requirements and buffers established by its national supervisor. ***Grade A+ banks are subject to an additional requirement of having a CET1 ratio meeting or exceeding 14% and a Tier 1 leverage ratio meeting or exceeding 5% on top of the requirements for Grade A banks. ****0%-20% for those in AA-category sovereigns.

Source: Fitch Ratings, China Banking and Insurance Regulatory Commission & BBVA Research

The exposure to local government bonds and high-quality corporate borrowers are subject to less capital charge while the exposure to interbank activities .are subject to more capital charges. In sum, the overall level of capital adequacy ratio in the Chinese banking sector will remain stable under new rules.

China's global systemically important banks face TLAC shortfall

RELATIONSHIP BETWEEN TLAC AND BASEL III

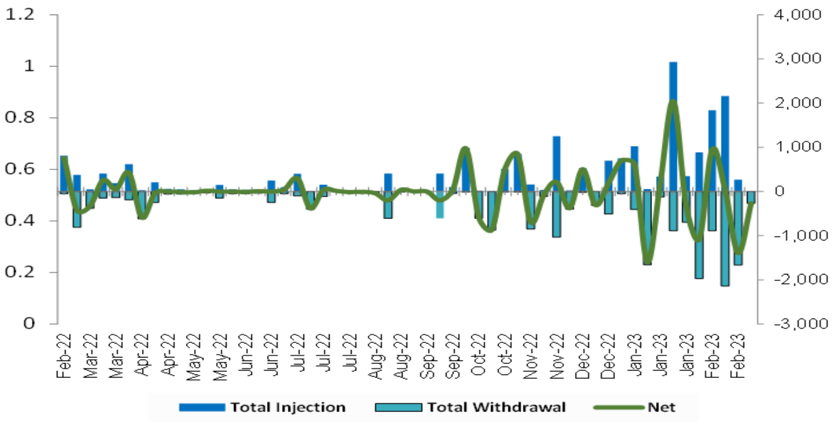


Source: FSB & BBVA Research

The capital shortage major banks faced will be accelerated in the next few years to meet the TLAC rule, which will be implemented at the start in 2025, with a higher requirement taking effect in 2028. It is expected that the top 4 Chinese banks will need to raise RMB 3.8Tn in capital to meet the regulation needs in 2025.

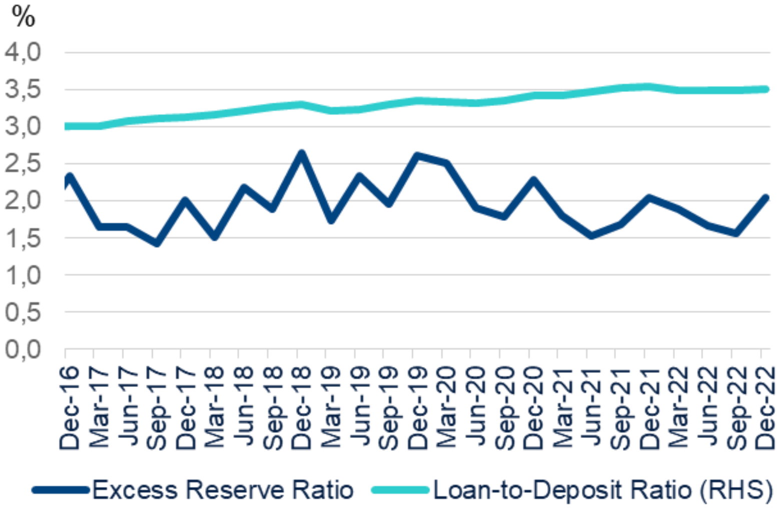
Banks' liquidity remained adequate

CHINA PBOC ACCELERATED OPEN MARKET OPERATIONS IN THE SECOND HALF YEAR



Source: Bloomberg & BBVA Research

EXCESS RESERVE INDICATES THAT LIQUIDITY IN THE BANKING SYSTEM REMAIN ADEQUATE

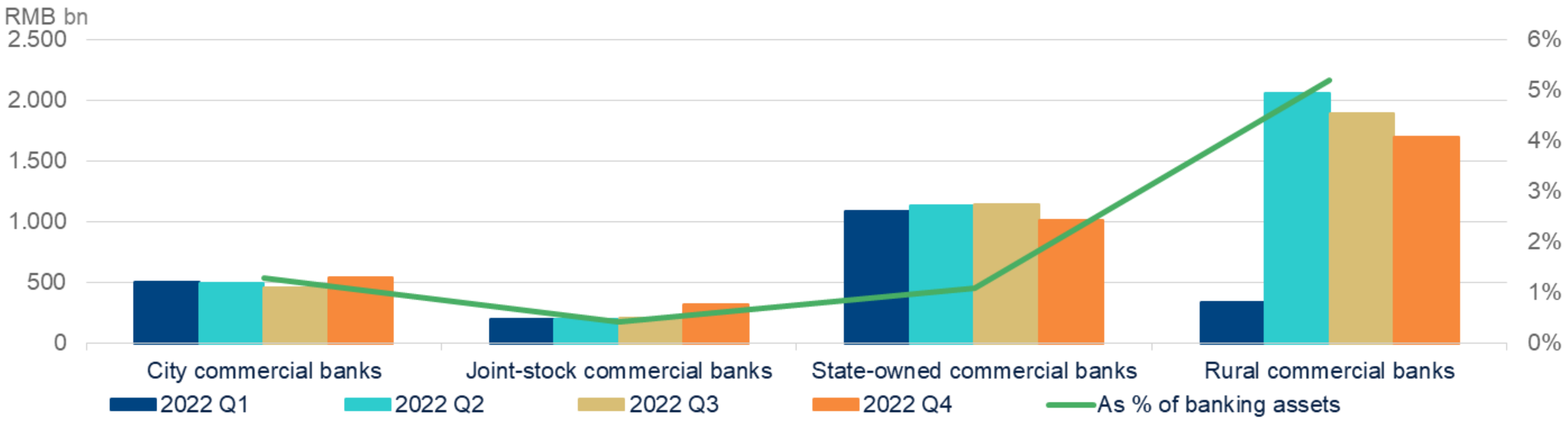


Source: CBRIC & BBVA Research

The PBOC has accelerated the pace of net liquidity injection given the slow economic growth during 2022. Excess reserve ratio remained at 2.1% in Q4 2022, 10 basis points higher than a year ago, indicating that liquidity in the banking system remain adequate after the PBOC cut the RRR and benchmark interest rate.

Small banks' reliance on negotiable certificates of deposits (NCDs) as funding source decreased

BALANCE OF COMMERCIAL BANKS ISSUED NCDS BY BANK TYPES



Source: Shanghai Clearing House & BBVA Research

Small banks reduced their reliance on interbank negotiable certificates of deposits (NCDs), which alleviated the concern that cross-holdings of bank securities among financial institutions will trigger crisis contagion during market distress.

Banking sector enter 2023 with greater headwinds

Asset growth	Asset growth is likely to continue its growth in 2023, albeit at a slower pace, as the government pushes large lenders to extend new credit to infrastructure and unfinished property projects. Loan growth will picked up next year as Chinese banks pledged billions in credit support to help struggling developers. Corporate lending is likely to dominate the sector's loan growth in the 2023, while loan demand from households and the private sector is subject to uncertainties.
Asset quality	Banks' NPL ratios will likely increase moderately in 2023 as asset risks are rising amid a deteriorating operation environment. Large banks have built strong loan loss reserves, while some smaller regional banks continue to be under more pressure as they have greater exposure to property-related businesses.
Profitability	We expect banks' profitability to underperform in 2023, as most banks have lowered corporate and mortgage loan lending rates amid the authorities' call to lower companies' and homebuyer's funding cost. In addition, banks will continue to write off bad debts at a pace faster than before. The authorities will carefully manage the liquidity of interbank market, which can partially offset the adverse impact of narrowing net interest rate margin.
Capitalization	Banks need to replenish capital through perpetual bond and equity issuance in support of their credit expansion.
Shadow banking	Shadow banking assets will retreat further amid strict regulatory supervision. Interconnectedness between banks and NBFIs is set to decline further in 2023.

BBVA Research

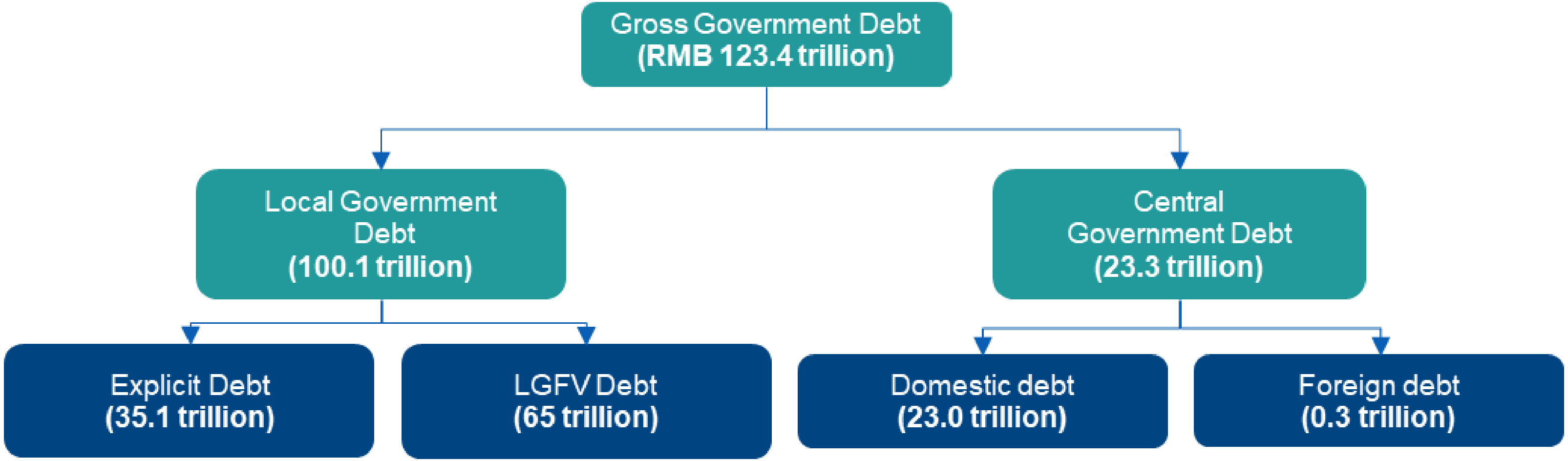
03

Property market risks could exacerbate the debt overhang problem

The potential weakness in the real estate market posted risks for China’s financial institutions.

“Hidden debts” issued by the LGFVs debt will pose risks to the banking sector

DEBT STRUCTURE OF CHINA’S GOVERNMENT DEBT BY 1H 2022

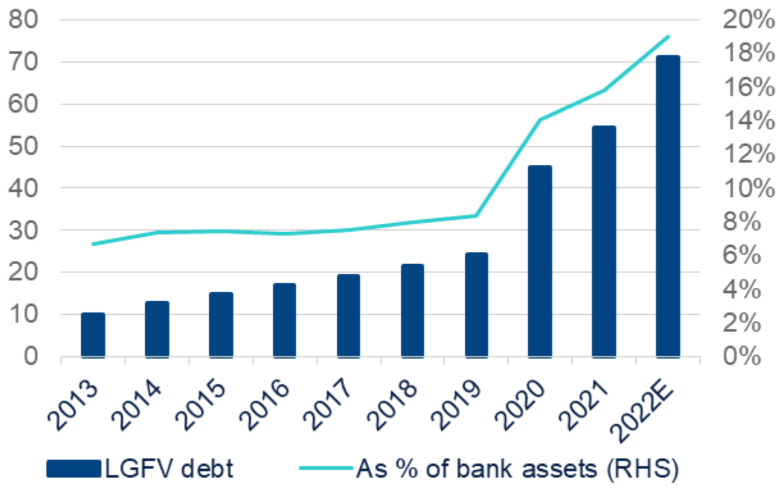


Source: CBRIC, S&P rating, CEIC & BBVA Research
* The ”Hidden debt” issued by local government financial vehicles, entitles created to circumvent borrowing restrictions through borrow off-budget capital to facilitate local infrastructure and public projects.

China’s local government debt had already been rising dramatically for a decade before the pandemic, largely the result of a state-led investment boom in the wake of the 2008 global financial crisis. But the situation has largely deteriorated in the past several years.

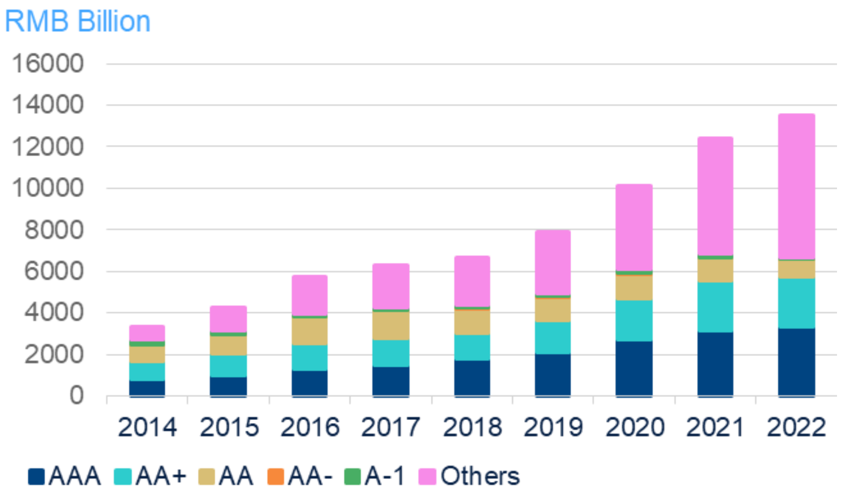
Local government debts have increased rapidly over the past several years

LOCAL GOVERNMENT DEBTS HAVE GROWN FAST IN THE PAST SEVERAL YEARS



Source: CBRIC, S&P rating, CEIC & BBVA Research

DEFAULT RISKS AMONG WEAKER LOCAL GOVERNMENT FINANCING VEHICLES ARE RISING

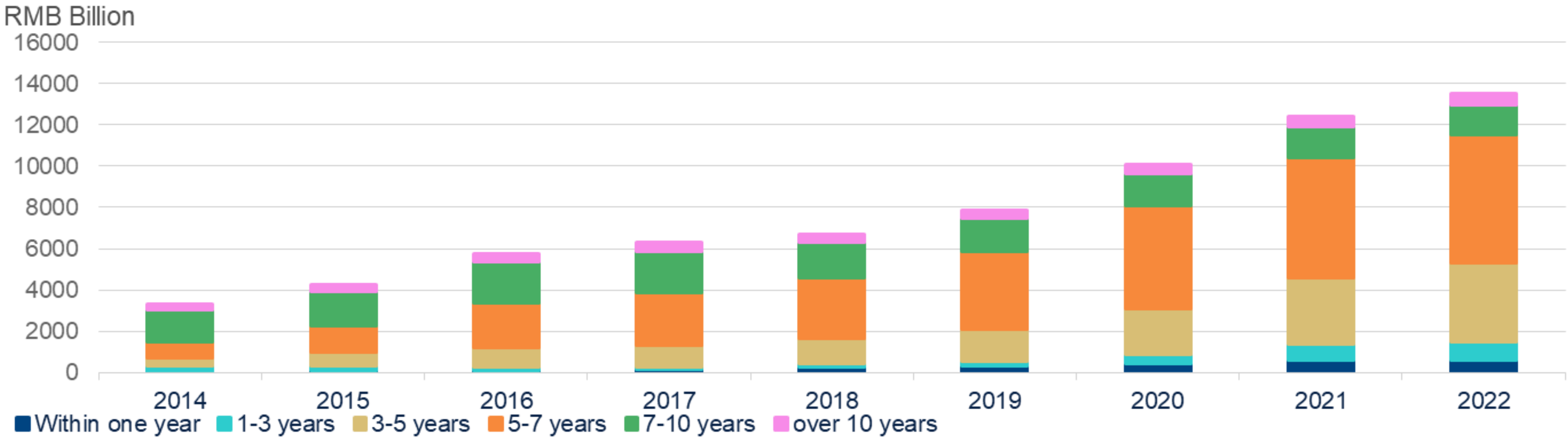


Source: PBoC & BBVA Research

It is estimated that the LGFVs totaled RMB 71 trillion by the end of 2022, or around 19 % of banking assets. China's weaker LGFVs are facing higher risks of default and missed payments amid rising financing costs, a wave of maturities and a property crisis that is taking a toll on local authorities' balance sheets.

Most of LGFVs debt listed in stock exchange will mature in 5-7 years, while majority proportion of offshore debt will mature in 2 years

MOST OF LGFVS DEBT IN LISTED FIRMS WILL MATURE IN 5-7 YEARS



Source: Wind & BBVA Research

Most of LGFVs det in listed firms will mature in 5-7 years, while 84% of Chinese LGFV's USD 84.2 billion of offshore debt will mature by 2025. Default risks among weaker local government financing vehicles have increased.

Stress test: LGFV debt default could impose financial risks

SOLUTIONS FOR SOLVING THE IMPLICIT LGFV DEBTS DEFAULT:

Many measures could be used by defaulted LGFVs to repay the debt. i) Use annual budget funds, excess revenue, and revitalize financial stock funds to repay debts; ii) Transfer of government equity and operational state-owned assets; iii) Repayment through borrowing or roll-over debts; iv) Bankruptcy & liquidation.

Stress test:

Stress test	Pre-test	Scenario	Scenario 2	Scenario 3
NPL ratio	1.6%	3.6%	5.5%	7.5%
Bank net profit (RMB Trillion)	2.3	-1.3	-4.8	-8.4
Bank capital ratio	15.2%	13.1%	11.1%	9.2%

ASSUMPTIONS:

- Scenario 1: 5% of LGFVs debts get defaulted.
- Scenario 2: 10% of LGFVs debts get defaulted.
- Scenario 3: 15% of LGFVs debts get defaulted.

STRESS TEST RESULT (RECOVERY RATE = 0):

- Banks' net profit will turn negative under all the above three scenarios. Banks need to set aside all of their net profit to write off the bad loans.
- Banks NPL ratio will increase to 3.6% and 5.5% under scenario 1 and 2; banks NPL ratio will rise to 7.5% under scenario 3.
- Bank's capital adequacy ratio will drop to 13.1% and 11.1% respectively Under scenario 1 and 2 ; bank's capital adequacy ratio will fall below the minimum requirement of 10.5% under the scenario 3.

Default risks among weaker local government financing vehicles have increased. The risk of idiosyncratic LGFVs defaults in weaker economic regions is rising, but the danger of systematic defaults remains low due to the importance of LGFVs for policy implementation and potential implications for the capital market.

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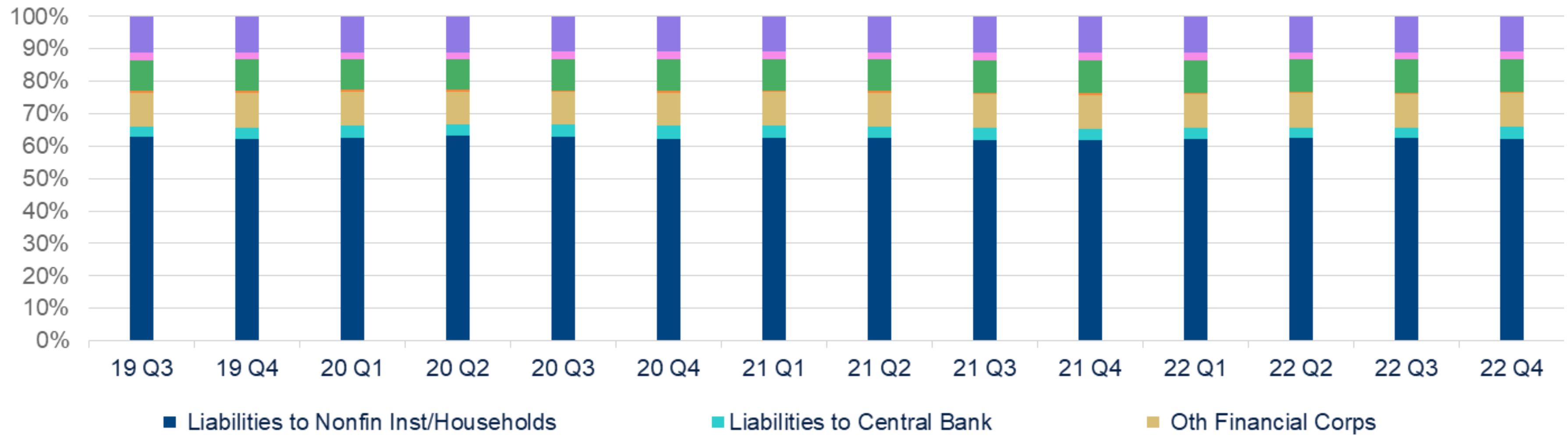
04

Shadow banking activities

Banks interconnectedness with the shadow banking system has further decreased

Banks' fund dependence of shadow banking system has decreased moderately

BREAKDOWN OF BANKS LIABILITIES

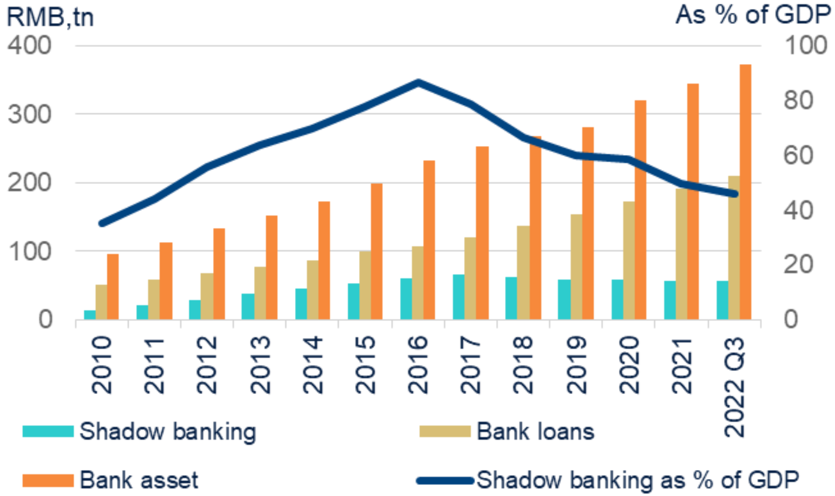


Source: Haver & BBVA Research

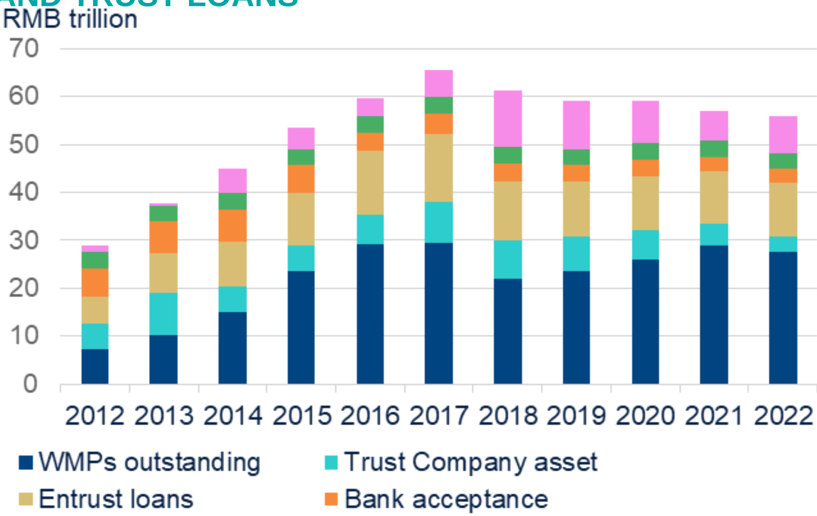
Bank's reliance on other financial institutions has been reduced slightly This trend will likely continue in 2023 thanks to regulators efforts to guard against banks' involvement in certain shadow banking and interbank activities. 2022 becomes the first years for banks to fully comply with new asset management regulations promulgated in 2018.

China shadow banking assets continued to trend down

SHADOW BANKING ASSETS AS % OF GDP CONTINUED TO TREND DOWN



THE DECLINE OF SHADOW BANKING SECTOR IS WEIGHED BY WEALTH MANAGEMENT PRODUCTS AND TRUST LOANS

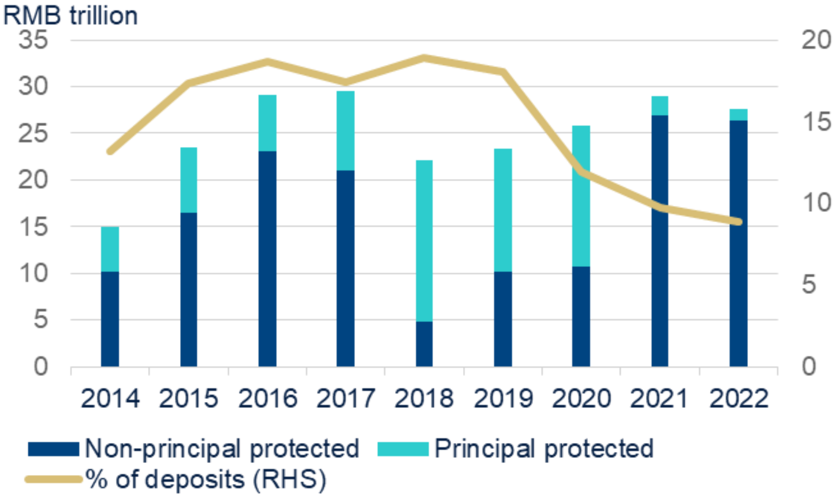


Source: CBIRC, Moody & BBVA Research

The broad shadow banking assets continued their declining trend in the past 5 years, with total shadow banking assets moderating to RMB 55.9 trillion in Q3 2022 from RMB 57.6 trillion in the previous year, although at a slower rate. The contraction was mainly weighed by the decline in WMPs and trust loans.

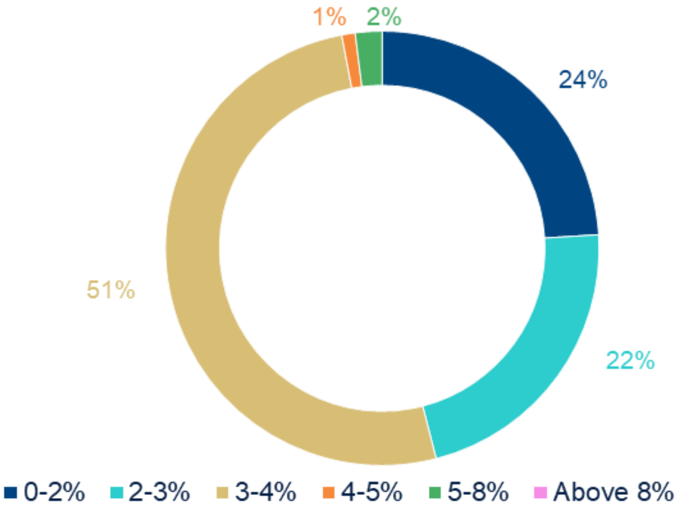
Interbank and non-standard wealth management products continue to shrink under enhanced regulatory efforts

PRINCIPAL PROTECTED WMPS OUTSTANDING HAS FURTHER DECLINED



Source: China Banking Wealth Management Market Annual Report & BBVA Research

THE YIELD OF WMPS CONTINUED TRENDING DOWN

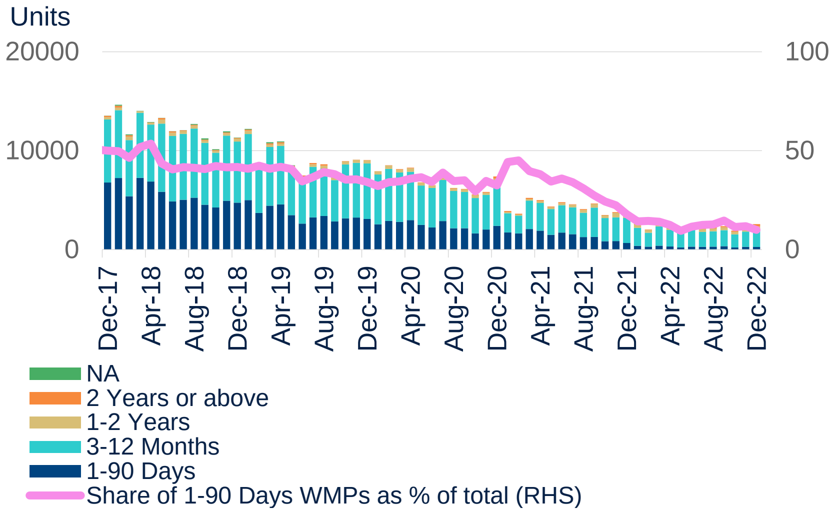


Source: Wind & BBVA Research
*According to the WMPs that has published yield rate

WMPs, which used to act as a major funding channel for regional banks or highly leveraged companies, shrank to RMB 27.65 billion in the 2022 compared to RMB 29.0 trillion a year ago. More importantly, banks are not allowed to provide principal guarantees for issued WMPs under the new regulatory framework.

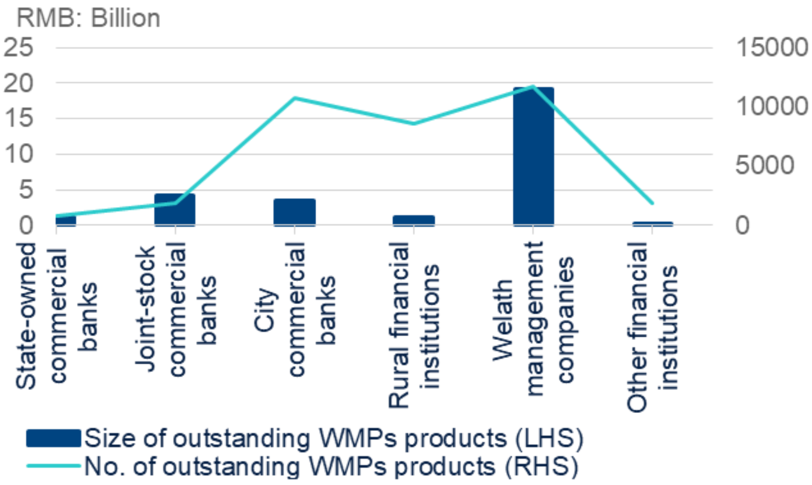
Maturity mismatch between WMPs and underlying assets has lessened

SHORT TERM WMPS OUTSTANDING HAS FURTHER DECLINED



Source: Wind & BBVA Research

BANKS ESTABLISHED WMP COMPANIES TO CONDUCT RELEVANT BUSINESSES SO AS TO RING FENCE ASSOCIATED RISKS

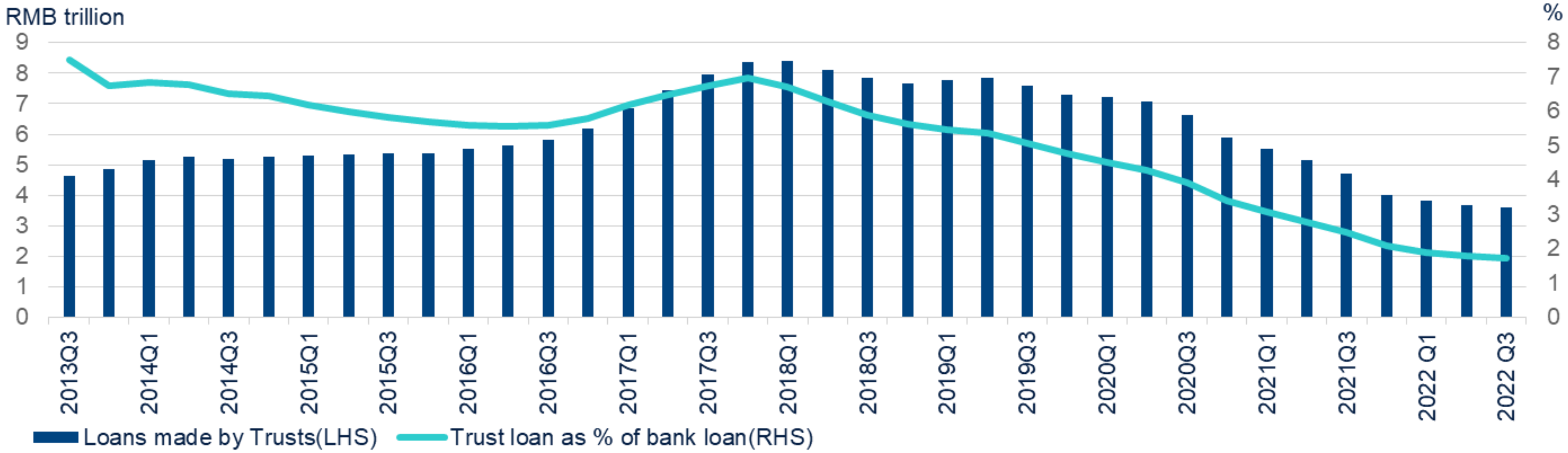


Source: China Banking Wealth Management Market Annual Report & BBVA Research

WMPs with short maturities (below 3 months) are relatively stable with their share around 40%, helping to reduce maturity mismatch risks between WMPs and underlying assets.

Contraction in trust loans continues

TRUST COMPANY LOANS CONTINUED TO DECLINED

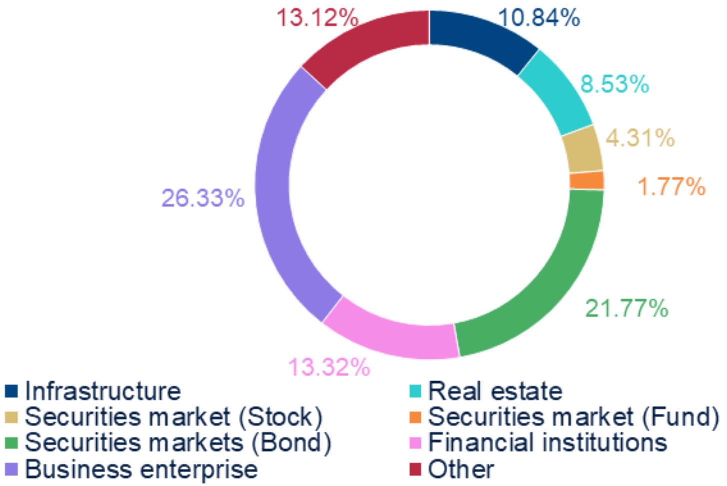


Source: China Trustee Association & BBVA Research

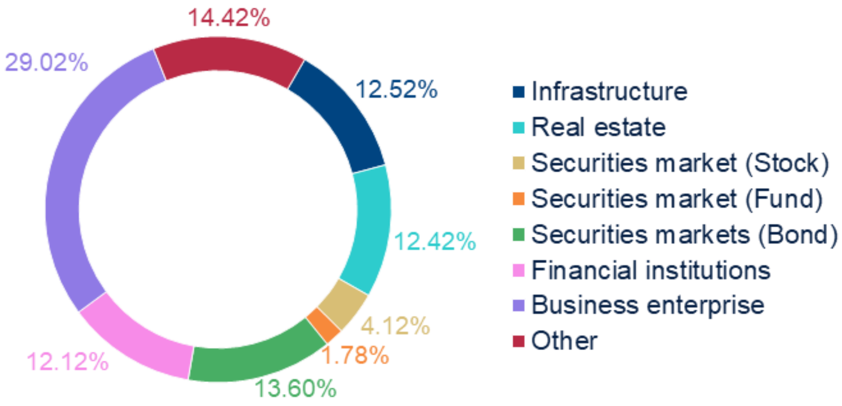
The fast contraction in trust loans reflected the rising risks of real estate sector. Trust companies were scrambling to reduce their credit exposure to property developers.

Trust assets pivoting away from infrastructure and real estate to bond market

AUTHORITIES PUT STRICT MONITOR ON THE FINANCING CHANNEL FOR INFRASTRUCTURE AND REAL ESTATE



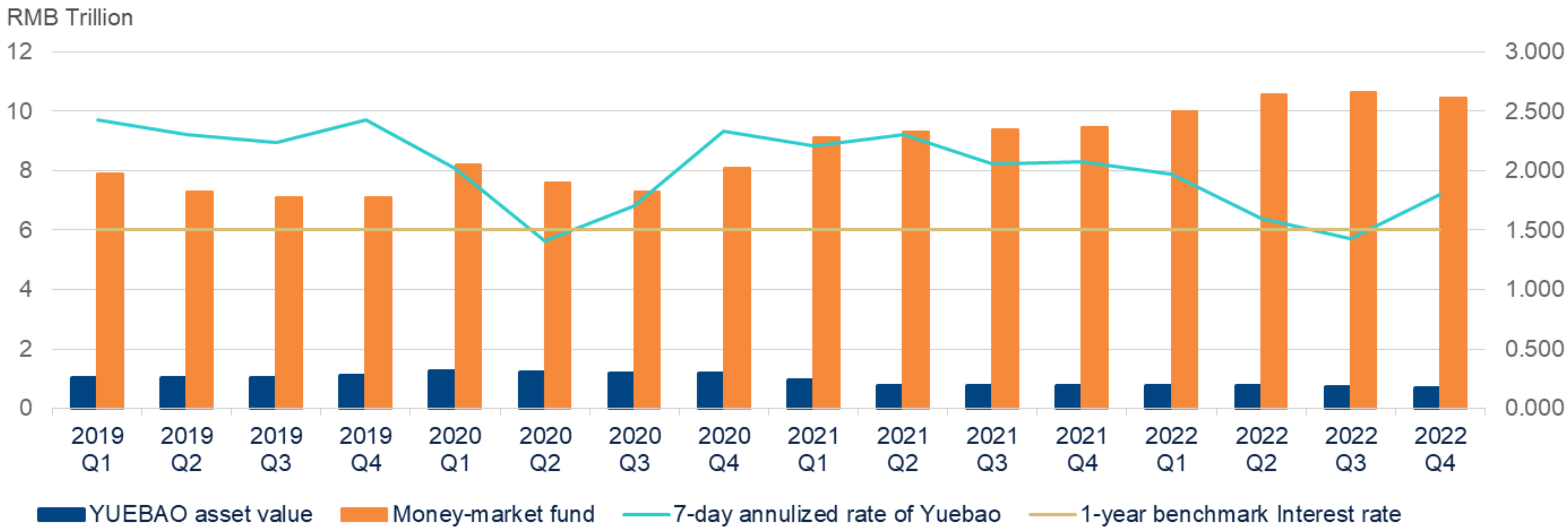
Source: China Trustee Association & BBVA Research



Source: China Trustee Association & BBVA Research

Despite the shrinking size of trust loans to real estate and infrastructure, the downturn in the real estate sector still poses significant credit risks to trust firms.

Money market funds attract massive capital inflow amid weak investment



Source: Wind & BBVA Research

Although returns on money market funds fell substantially in 2022, the total value rose to RMB 10.5 trillion by end-2022. It reflected investors' strong preference for short-term and safe investment instruments under an highly uncertain environment.

Key regulatory developments in 2022

Date	Key regulatory developments
22-Jan	The CBRC issued the "Measures for the Management of Project Companies of Financial Leasing Companies", which regulats that financial leasing companies will need to carry out financial leasing business in the form of project companies, clarify the business scope of project companies and improve management systems and mechanisms.
22-Jan	The SFC has issued the "Interim Provisions on the Supervision of Important Money Market Funds (Draft for Comments". The "Interim Provisions" impose more stringent and prudent requirements on a number of indicators for important money market funds, including: leverage ratio, single issuer/investor, concentration, the proportion of specific assets, and a minimum percentage of holdings high-quality assets with high liquidity, etc.
22-Feb	The CBRIC issued the " Administrative Measures for Trust Industry Protection Funds and Liquidity Mutual Funds (Draft for Comments)", proposing new measures for the Trust Industry Protection Fund. One of the key adjustments is the simultaneous establishment of two parallel funds, including a newly trust industry protection fund (the "New PPF") and the original subscription-based fund remnamed as the "Liquidity Mutual Fund". The New PPF will provide relief to trust companies facing general liquidity risk to help them resume normal operations. The latter, in turn, will continue to be available to trust companies seeking short-term liquidity support in response to operational risks and liquidity stress.
22-Apr	The CBRIC has issued a Notice on Matters Relating to the Adjustment of the Classification of Trust Business, which proposes that trust business will be divided into three main categories: asset management trusts, asset servicing trusts and public welfare/charitable trusts. The new classification will excludes financing-related trust business. The new framework will help clarify the direction of trust business transformation.
22-Jun	The Ministry of Finance issued the "Regulations on Accounting Treatment Related to Asset Management Products", which has come into effect from 1 July 2022. The new regulations will unify the accounting treatment methods related to most asset management products in the market and raise the standard of overall financial instruments.
22-Jul	The CBIRC issued the "Measures for Capital Management of Financial Asset Investment Companies (Trial)". The main provisions include the calculation of Tier 1 and Tier 2 capital adequacy ratios, measurement of risk-weighted assets, calculation of leverage ratio and internal capital adequacy assessment procedures.
22-Jul	The CBIRC issued "Further Notice on Regulation of Commercial Banks' Internet Lending Business", in order to further regulate the online lending business of commercial banks, and promote the stable and healthy development of online lending.
22-Aug	The CBIRC issued the "Regulations on the Administration of Insurance Asset Management Companies, effective from 1 September 2022, which treat domestic and foreign insurance company shareholders of insurance asset management companies equally, remove the upper limit of foreign ownership and set conditions for uniform application.
22-Aug	The PBOC, together with the National Development and Reform Commission, the Ministry of Finance, the CBRIC and the SFC, jointly issued the "Notice on Promoting the Healthy Development of the Credit Rating Industry in the Bond Market", which came into effect on 1 September 2022. The new regulations recommend that credit rating agencies to establish quality assessment mechanisms and conduct cross-validation in order to improve credit rating standards.
22-Aug	Following the release of the consultation draft on 29 April 2022, the CBRIC issued the "Measures on Internal Control of Wealth Management Companies" to enhance management. The new regulations require wealth management companies to establish a prudent internal control management mechanisms and organisational structures, covering various business and management activities. A comprehensive assessment will be conducted at least once a year.
23-Mar	The "two sessions" announced to establish the super regulator for the financial sector-National Financial Regulatory Administration to replace and unify the previous China Banking and Insurance Regulatory Commission (CBIRC), consolidating financial system regulation and oversight, which aimed at closing loopholes with multiple agencies monitoring different aspects of financial industry.The setting up of the new super financial regulatory body comes as the authorities seeks to rein in large corporate and financial institutions that may bring systemic financial risks through regulatory arbitrage among previous multiply authorities.

Source: Moody, Government Work Report & BBVA Research

Disclaimer

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China Banking Monitor

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Creating Opportunities